Market Crashes, Student Debt, & Old 401(k) Plans

Tom Mullooly: Welcome to the Mullooly Asset podcast. This is episode number 203.

Tim Mullooly: This is Tim Mullooly.

Tom Mullooly: I am Tom Mullooly. Welcome to the show. In this podcast what we do, is we get questions that come in through our mail bag and we pick out some of the ones that we think will appeal to most of our listeners. Tim, why don't we jump right in with the first question this week?

Tim Mullooly: Sure thing. The first question asks, "Where should I move my 401(k) gains before the bull stock market ends in preparation for a market crash?" The summary says...

Tom Mullooly: We're both looking at each other like, "Okay ..."

Tim Mullooly: What a way to start it off with a doozie. The summary goes on to say, "My 401(k) accounts do not have the option to automatically sell at a stop point. How do you recommend that I lock in my gains before the bull stock market ends? Is it better to move my gains into my 401(k) money market or move them into my 401(k) defensive stock position? For example, a utilities fund."

Tom Mullooly: Well, if the market's going to crash, everything crashes.

Tim Mullooly: Your utilities fund would crash, too.

Tom Mullooly: Right. Everything will go down. Some will go down more than others, but how do we know when we're going to have a crash?

Tim Mullooly: You don't.

Tom Mullooly: Tim, you had a good line right before we turned on the microphone.

Tim Mullooly: Right, this person asks, "How can I prepare for a market crash?" It's like, well, how can you prepare to get struck by lightning? You don't know when that's going to happen. The odds of that happening are very slim.

Tom Mullooly: Right.

Tim Mullooly: They should be more prepared for a bear market.

Tom Mullooly: Right. I think sometimes people get hung up on the jargon though, and they think crash equals bear market. 1973, 1974, bear market. It was two plus years of just slow grinding losses, and it just wore everybody out. Crashes, like the one in 1987, like we've had a couple of times since then, they're quick. They're sometimes out of the blue, most times they're not though. They usually, I can't say always, but many times when there is a short term correction, the market comes back. The answer to this also depends on the age of the person asking the question.

Tim Mullooly: Right. For someone who's 29 years old and they have money in a 401(k) and they're trying to lock in their gains, I would recommend, don't do that. You're 29 years old. You can live through it and you should. It changes as you get older. The advice for the 29 year old may not hold up as much for a 49 year old or a 69 year old.

Tom Mullooly: Definitely not.

Tim Mullooly: If you're 69 years old, you're getting close to retirement and maybe starting to take money from that 401(k), it might be a good idea to lock in those gains and move it to a money market or some sort of cash equivalent in your 401(k) plan to keep it safe.

Tom Mullooly: Or at least something more of a conservative allocation. If you're someone who's at the retirement zone, if you're in your 60s, yeah, you should be thinking about repositioning this account so that it is more conservative in nature. You should do that now anyway.

Tim Mullooly: Even if it's a bull or a bear market, like Tom said, you should be doing that anyway at that age.

Tom Mullooly: Right. I think there's a misunderstanding in the general public about what these 401(k) accounts are all about. Here in the office, we run into people who consider this Vegas money. Its like, "Well, I got to step on the gas with my 401(k) because I need to double this before I retire."

Tim Mullooly: That's not how it works.

Tom Mullooly: It just doesn't work that way, but some people feel that this is hot money and they need to be moving it. I was really surprised 10 years ago when plan administrators started to put collars on how many transactions you can make in a month or a quarter in your 401(k) account. As an advisor, the first time I saw that I said to myself, "That is ridiculous. Who's doing that? Who's making that many transactions in their account?"

Tim Mullooly: Someone getting close to retirement that's trying to find that magic sauce to double their account in a couple years but, you know, just transacting their way to lower returns most likely.

Tom Mullooly: Yeah, so the answer to, "Should I move my 401(k) gains before the bull market ends," it depends on your age, it depends on your circumstances. We need a little more information than what we've got here, but I cringe when I hear these kind of questions, because it just tells me that whoever this person is, they have the completely wrong attitude about retirement and their retirement account. Let's move on.

Tim Mullooly: The next question asks, "How should I approach paying off my student debt?" The summary, real quick says, "Should I pay the minimum amount required each month, or pay off as much as I can afford every month?"

Tom Mullooly: Well, I would prefer to see someone pay off as much as they can handle every month. The problem, though, is that some people go a little overboard and if you're paying money into something that you don't have access to in the future, if you're paying off a debt and then you run into a cash crunch at some point in the future, you're going to really regret paying off as much debt as you did.

This is a good opportunity to remind people that that bill or invoice or payment book that you get regarding your student loan that is the minimum that it will take. You can pay your loan off faster and no one is going to have a problem with that. The sooner the better, but you need to make sure that you've got that safety cushion, you've got a reserve, several months of fixed expenses set aside before you can do that, and then we would encourage all of our listeners that have student loans or car loans or mortgages over and above that, get rid of it. Get rid of it. Debt makes you a slave. Don't ever forget that.

Tim Mullooly: The good thing about this question, though, is that at least the person is paying off their student debt.

Tom Mullooly: We get questions a lot about, you know, "How can I get out of this obligation that I've got?"

Tim Mullooly: It's really hard to get rid of or have your student debt forgiven. Some people have the idea in their head, "Well, there's always bankruptcy. Right?" We've actually gotten that question a couple times. Unfortunately, bankruptcy doesn't wipe away your student debts, so that's not really an option. We actually, this week's video for the Mullooly Asset Show is covering that exact topic. If you want to know more about that, definitely check out the video when it goes up this week.

Tom Mullooly: Yes. Make sure to tune into the Mullooly Asset Show episode number 67, that's our video over on the website and also on YouTube.

Tim Mullooly: Yep, it'll cover pretty much everything you want to know about that topic.

Tom Mullooly: Tim, a somewhat related question came in and they said, "What is the best way to pay off graduate school debt using my 401(k)?" We did not plant these questions. They came in random, but they're too good to pass up, especially since the previous two questions were on these topics.

The summary goes on to say, "I have grad school debt," so we have to assume that they're out of grad school. "I have grad school debt that I'm trying to pay off as soon as possible. I have savings in my 401(k) and I'm trying to determine the best way to use these funds to help pay off my education loans." They have loans. "What would be the most tax efficient way of doing so? Should I roll over my 401(k) to an IRA? Is it possible to avoid paying the 10% penalty and taxes?" A lot to unpack here.

Tim Mullooly: Right, and unfortunately for this person, you really could only use your 401(k) funds to help you pay your tuition for college. Now that they already have the loans, you can't really take a hardship withdrawal from your 401(k) to be able to pay back student loans, so there really isn't a way. The same thing would go for an IRA. There really isn't a way to use those funds to pay for loans that you already have.

Tom Mullooly: Tim, I want to just back up a moment and let's see if we get the facts right. It seems that this person has been working for a while, has a 401(k) balance, but they went back to grad school, maybe they went at night, and now they have loans for their education that they've got to pay back. They've got this money sitting in a 401(k). The first thing that I would say is, I think a good discussion to have with a financial planner would be, why are you still contributing to a 401(k) when you're going to school at night? You could use that money for tuition. That's the first thing.

The second thing is, like you said, they could have used the money while they were going to school as a hardship withdrawal to pay the tuition as they were going along, instead of piling up the loans. Now the problem is, they've got a 401(k) balance, but they also have student loans. Can they take the money out of the 401(k)? They really, if they're working, they can't even take the money out of the 401(k). They'd have to leave the company to do that. They can't even do that.

Tim Mullooly: This person kind of backed themselves into a corner by asking this question after they already put the money in the 401(k) and got the loans.

Tom Mullooly: I'm sorry this is going to sound crude, but you know, light the barn on fire and then ask what are the safety provisions that we have? Do we have a fire extinguisher?

Tim Mullooly: Yeah, and this goes to pretty much all of the questions that we get here. Just a simple conversation with a financial planner before you make some of these decisions would help so many of these people. We sit here and shake our heads, and it's like, you're asking these questions and a lot of them are after the fact. Think before you do some of this stuff guys, come on.

Tom Mullooly: A lot of financial planners will just tell you, even if you're a random call in, most people in general want to help other people. I think if someone just called in randomly and said, "Hey, here's my situation. Can you at least point me in the right direction?" I think a lot of people in our line of work would be interested in helping someone at least not make a fatal mistake. One thing that this person can do in this particular situation is, if they haven't taken a loan from their 401(k), they may be able to take a loan from their 401(k) and use that money to pay off the student loan. They're trading one loan for another. You have to check the interest rates to see if you're getting a better deal on something like that.

There is a way to do it, but the other thing that I caution you to before you do that is, the nominal interest rate may be better. Maybe you're paying 7% on a student loan and you're paying 5% on a 401(k) loan. The other problem that you have to look into is, most times when you take a loan from a 401(k), it needs to be paid back in five years. Your student loans, they're usually 10 years. This person could also look into an income based repayment schedule where they pay it over 20 years and pay a lot less. We cover that in the video.

Tim Mullooly: Right, so this person does have a couple options here. Probably not the options they were looking for, but ...

Tom Mullooly: This person needs to talk to a financial planner.

Tim Mullooly: Yeah, that's the long and short of it. Let's move onto the final question for episode 203. "How do I minimize the amount of taxes I pay when I sell shares from a former employer's 401(k) plan?"

Tom Mullooly: Okay Tim, it seems like in every episode we have one question that just makes both of us sit back in our chair and just give a big sigh.

Tim Mullooly: Yeah, this is definitely it. Oh, boy.

Tom Mullooly: Yeah. Here's the summary on this one. "I'm 34 years old and I have company stock from a former employer's 401(k) plan sitting in a brokerage account. I left the company five years ago. The company shares have significantly increased in value over the past 12 months. I'm skeptical if the shares will hold their value in the future, and I believe I should sell high and move the funds into my IRA." All right, let's just pause for a second. There's nothing that says he has to move the money into an IRA. The money can stay in his 401(k), but let's just move on with his question. "I know that if I sell the shares I face tax implications."

Tim Mullooly: Wrong.

Tom Mullooly: Totally wrong. He or she then goes on to say, "I'm trying to determine whether I should attempt to sell the shares, and if so, what's the best way possible to minimize the amount of taxes I'm required to pay?"

Tim Mullooly: The reason that this makes me shake my head is that, this person is probably not the only person who thinks along these lines, and it just shows the lack of education towards these plans that they're just piling money into.

Tom Mullooly: Tim, let's not pick on the individuals. It's the plans themselves and the employers that don't really do a good job educating the participants on the ins and outs of these things. This person clearly has bad information.

Tim Mullooly: Exactly. That was more my point, too. The person asking the question has some responsibility, but most of the responsibility here falls on the employer and the plan providers to educate the people that are in the plan as to what the details of the plan are.

Tom Mullooly: Do you want to just address the issue of taxes and selling stock inside the plan?

Tim Mullooly: Sure. This is a 401(k) plan, so like any retirement account, buying and selling within the plan isn't going to cause any tax implications at all.

Tom Mullooly: None whatsoever.

Tim Mullooly: As long as the money stays within the plan, you're not going to have any tax implication.

Tom Mullooly: That's right.

Tim Mullooly: If this person thinks that, he says they're skeptical the shares will hold their value in the future and he wants to sell high, then sell high. They're not going to have any tax implications because it's within the 401(k) and he's not talking about taking the money out of the 401(k).

Tom Mullooly: Right. Again, to summarize, the only time that you're going to have any tax implications is if you take money out of the 401(k) and don't roll it over into an IRA.

Tim Mullooly: Right. I was going to say, even if this person chooses to move the money after he sells it into an IRA that still wouldn't cause any tax implications because it's a roll over from a 401(k) to an IRA.

Tom Mullooly: That's right. Tim, you and I have done some work over the last year with the Department of Labor changes that have been potentially coming on, then delayed, then they're probably going to come on at some point. There's still a lot of folks out there that could be impacted by the Department of Labor changes if and when they ever get pushed through. This is an area that is worth spending a minute to talk about. It used to be standard discussion, people would say, "I'm leaving my old job." The first thing that a broker or an advisor would tell the person they're talking to is, "We're going to roll that money into an IRA." Why is that not necessarily the right thing to do every time?

Tim Mullooly: Yeah, it's definitely not a blanket answer where that's 100% the right thing to do for everyone, because some plans, the options within the plan, they've negotiated really low fees for people, and moving money out of the 401(k) plan is going to cost the client more money in the IRA when they have to buy the funds or the expense ratios on these funds. It could be more cost effective for the client to leave the money in the 401(k).

Tom Mullooly: That's right. Now, there are some plans that have very limited options, and if you do roll the money into an IRA, you're going to have potentially unlimited investment options, so you've got more potential to do other things. It's not a blanket decision anymore that you must roll the money from a 401(k), once you leave a firm, into an IRA.

Tim Mullooly: I feel like some people might have the notion based off of these potential changes with the Department of Labor that they always want you to do the opposite and leave the money in the 401(k), and that's not necessarily the case either. I think the changes that are going to come about, pretty much just are asking advisors to have more of a discussion and dig into which one is going to be better than the other. It's not necessarily you need to leave it in the 401(k) or you need to move it to an IRA. You got to do your research and figure out which one's better.

Tom Mullooly: I think what you're trying to say is that individuals need more information and a little more awareness in terms of what their options are.

They do have options, and it's something that, while you don't want to confuse people with too much information, I think they have a right to know that, hey, you don't necessarily have to do this or that.

You can take your time and decide. It's a good topic. Good questions today in episode 203. Thanks, everybody, for listening, and join us again in episode number 204.